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OPEC and the USSR: The Oil Connection

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An Intelligence Assessment

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An Intelligence Assessment

This paper was prepared by [redacted] Office of Global Issues. Comments and queries are welcome and may be directed to the Chief, Energy Issues Branch, OGI [redacted]

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Key Judgments
Information available as of 18 October 1983 was used in this report.

OPEC's recent contacts with the Soviet Union enhance Moscow's standing with members of the oil cartel and provide a forum for continuing Soviet efforts to better relations with the conservative oil producers of the Middle East. As yet, the new contacts have not given the Soviets access to important officials other than the Algerian Oil Minister. Further consultations are planned, however, and these should provide the Soviets with additional opportunities. Moscow is particularly interested in establishing a diplomatic foothold in Saudi Arabia and improving its deteriorated relationship with Iran. [redacted] 25X1

OPEC at this point apparently favors further contacts with the USSR despite deep-seated distrust of Moscow on the part of Saudi Arabia and some other conservative Islamic states. These states have been able to divorce oil cooperation from other national policies—as they have demonstrated in the Iran-Iraq war—and they apparently intend to limit their contacts with the Soviet Union to the extent necessary to secure Soviet support in the oil market. [redacted] 25X1

Moscow shares an economic interest in higher oil prices with OPEC countries, and at present the Soviets are espousing cooperation both to further political ambitions through improved relationships with OPEC members and to encourage cartel policies to uphold prices. Soviet cooperation so far has been superficial because the Soviets have not voluntarily reduced their export volume [redacted] 25X1
25X1 In the short term, the Soviets are driven by hard currency needs to try to maximize their oil revenues and are not prepared to limit their own exports to help OPEC. [redacted] 25X1

The market and the Soviets' own export capabilities will determine whether Moscow is able to continue to reconcile its political and economic interests with respect to OPEC. Under conditions similar to the present oil market, the Soviets could cast their inability to raise oil exports significantly as a gesture of cooperation. On the other hand, a sharp deterioration in market conditions could lead to greater friction if the Soviets, as we would expect, continued to export at their maximum capability. [redacted] 25X1

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Introduction

Algerian Oil Minister Nabi, representing members of OPEC, met with Soviet officials in early June to consult on oil policies. The meeting marked the first formal contact between the organization and Moscow. OPEC officials have said that the initiative was designed to solicit cooperation from major non-OPEC producers to prevent deterioration of the world oil market. OPEC members had become concerned that aggressive Soviet pricing and growing exports to Western countries were undermining the cartel's ability to stabilize prices. According to Nabi, Moscow agreed in June not to increase its exports to the West, and following the meeting the Soviets announced an increase in their crude export price to the OPEC benchmark of $29 per barrel. OPEC has announced plans for further consultations with the Soviets, providing Moscow a potential opportunity to expand relations with some individual OPEC members.

OPEC Relations With Non-OPEC Oil Exporters

The dramatic turnabout in the oil market in the past several years has forced OPEC members to change their attitude toward oil exporters outside the organization. Faced with rising demand in the late 1970s, OPEC members were confident that their hold on oil prices would continue to strengthen. In 1979, OPEC controlled 50 percent of world oil supplies and was in the midst of enjoying a runup in the OPEC benchmark price from $12.70 a barrel at yearend 1978 to $32.00 a barrel by mid-1980. Based on public comments, producing-country officials did not regard non-OPEC producers as a significant threat even though the cartel made unsuccessful attempts to recruit Mexico because of its potential to enhance OPEC's market control and its stature as a Third World leader. OPEC members disparaged contacts with the United Kingdom and Norway because their interests were considered more closely aligned with other Western industrialized nations and their export potentials were viewed as only marginal and temporary.

The Soviets also were considered only a marginal exporter with no significant influence over prices. Public and private statements by key OPEC officials indicate that they were unconcerned with Soviet ability to expand exports, tending to believe predictions by the CIA and other observers that Soviet oil output would soon peak with a concurrent decline in exports. This caused producers on the Persian Gulf to conclude that such developments would reinforce Moscow's expansionist designs on the Middle East—a perception that has hindered Soviet efforts to establish ties to many of the Persian Gulf oil exporters, particularly Saudi Arabia. 25X1

OPEC's share of the world oil market fell to just 35 percent last year, and the cartel was forced to absorb the full shock of declines in consumption and privately held inventories. At the same time, other major producers—particularly the United Kingdom, Mexico, and the Soviet Union—were able to expand exports at OPEC's expense, largely by pursuing independent pricing policies. As a result, OPEC cut its benchmark price in March 1983 from $34 a barrel to $29 a barrel, underscoring the cartel's diminished control over the oil market and altering the members' attitude toward cooperation with non-OPEC oil exporters. 25X1

Soviet Role in the Oil Market

Soviet exports of crude oil and refined products to non-Communist countries jumped to about 1.5 million b/d in 1982 after averaging just over 1.2 million b/d in previous years. By underpricing OPEC, Moscow was able to expand oil sales, including reselling some oil, acquired from OPEC members through barter deals, to the West for hard currency. Soviet oil exports earned about $14.8 billion in hard currency in 1982, accounting for more than half of total Soviet

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hard currency receipts from commodity exports.[1] Soviet crude and product exports to non-Communist countries were down slightly in first-quarter 1983—sales often are slack in the first three months—although crude and product deliveries were still about 1.3 million b/d.

More importantly, perceptions of future Soviet oil exports have changed dramatically. The midpoint of most recent industry projections of Soviet exports to the West in 1990 is 800,000 b/d, contrasting with earlier assessments that Moscow's exports to the West would be eliminated by the mid-1980s. Our own analysis that a decline in Soviet oil production and an increase in consumption will force reductions in exports during the 1980s is close to the consensus of industry forecasts.[2]

Recent Contacts

Concerned that competition from non-OPEC exporters would undermine their efforts to stabilize prices, OPEC members initiated contacts with Mexico and the United Kingdom to try to forge a coordinated arrangement even before the cartel cut prices in March 1983. London, while strongly denying any collusion and avowing its policy of allowing the market to determine pricing levels, adopted prices in line with those advocated by the cartel to avoid provoking retaliatory price cuts by Nigeria. Mexico, which later sent an observer to OPEC's Ministerial Conference in July, pledged to hold its exports near a 1.5-million-b/d self-imposed cap as long as OPEC restricted itself to the 17.5-million-b/d ceiling established in March. Mexico also held consultations with Venezuela before the two countries separately announced similar price hikes for heavy crudes in July and again in late September.

[1] Does not include trade with Finland, which is conducted through bilateral clearing arrangements.

Despite OPEC pricing moves, the Soviets continued to underprice the OPEC benchmark price, and cartel members became increasingly concerned about Moscow's behavior. Former Venezuelan Oil Minister Calderon Berti reportedly was the first to recommend formal discussions with the Soviets. Early this spring, Belkacem Nabi, the Algerian Oil Minister, was chosen by OPEC's four-member Monitoring Committee (consisting of Algeria, Indonesia, the United Arab Emirates, and Venezuela) to represent OPEC because of Algeria's good relations with the Soviets. 25X1

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Algerian press reports indicate that Nabi met on 6 June with Soviet Council of Ministers member I. V. Arkhipov and Deputy Ministers for Foreign Trade G. K. Zhuravler and N. G. Osipov. 25X1

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OECD data indicate that the Soviet Union delivered 550,000 b/d of crude to OECD countries in the first quarter of 1983. The Soviets apparently made no mention of product exports, which were about 560,000 b/d in the first quarter, according to OECD statistics. The Soviets also exported 150,000 to 200,000 b/d of crude and product to non-OECD, non-Communist countries. 25X1

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Recent Soviet pricing decisions have been couched in terms of supporting OPEC members; specifically, various reports indicate that Moscow promised Nabi that they would bring their prices up to OPEC levels. Moscow had boosted its price to $28.50 per barrel by adding 50 cents, effective 1 May; in late June, 25X1

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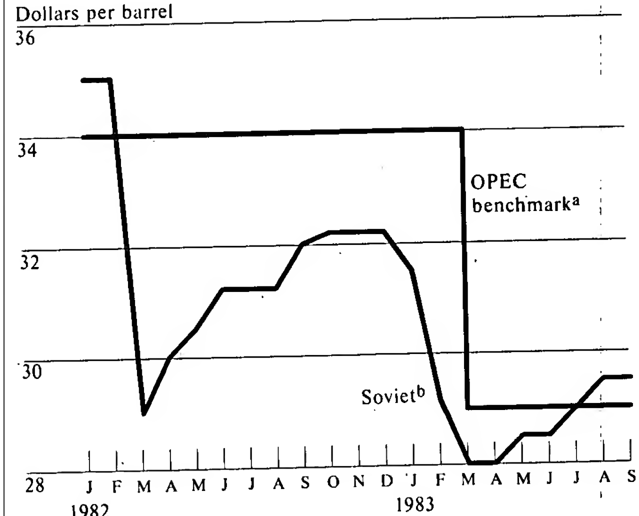
Figure 2
OPEC and the USSR: Official Crude Oil Prices



[a] Saudi Arab Light 34° API except for February 1983 when Saudis applied $30 per barrel price retroactively.
[b] C.I.F. Mediterranean price for Soviet Urals 32° API (C.I.F. Rotterdam price has normally been $0.10 higher).

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Moscow announced another 50-cent increase that brought its price in line with OPEC and in mid-August raised it to $29.50 a barrel. As for the volume of sales, the Soviets claimed that, out of consideration for OPEC, they would not increase exports. 25X1

Public Comments

Algerian Minister Nabi announced publicly in June that contacts between OPEC and the USSR will be "institutionalized," suggesting that OPEC would at least like to hold periodic consultations. Nabi claimed to be in charge of contacts with the Soviets and plans to meet them again later this year. UAE Oil Minister Utayba told the press that the USSR has reacted favorably toward market stabilization proposals. Utayba suggested that non-OPEC producers participate in devising a formula governing oil prices at the beginning of 1985, participation that would presumably include the Soviet Union. Utayba, however, ruled out the establishment of relations between the Arab Persian Gulf countries and the USSR, calling the issue premature. 25X1

Bilateral Oil Links

Moscow's emerging connection with OPEC helps underpin existing bilateral linkages the USSR has with most OPEC members. In some cases the soft oil market has worked to strengthen these energy-related ties by making the oil exporters more susceptible to special arrangements Moscow has been willing to broker. A key exception has been Saudi Arabia, which still keeps its distance from Moscow in oil and nonoil matters. For some OPEC countries, Venezuela

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in particular, the oil relationship remains one of the key connections the Soviets can point to in bilateral links with the country. [redacted]

Libya, Iran, Iraq. The Soviets enjoy their most extensive oil-related ties with Libya. For example, Moscow is extensively involved in onshore drilling activity, has participated in planning and designing the gas pipeline system, is constructing a major gas pipeline, and has sent a number of advisers to directly assist the Libyan Oil Ministry. The Soviets also regularly take oil from Libya as payment for arms. An estimated 140,000 b/d of Libyan oil was acquired in 1982, most of which the Soviets resold for hard currency in Western markets. Tripoli regarded the deals as the least lucrative outlet for its oil and decided earlier this year to phase them out in part to comply with its OPEC-assigned quota established in March [redacted]

The Iran-Iraq war has created difficulties for Moscow in its effort to stem the erosion of its influence in Iraq and at the same time take advantage of Tehran's political turmoil to gain a foothold in Iran.[3] Oil plays a role in Moscow's Iran-Iraq balancing act. This spring, for example, Moscow agreed to resume oil purchases from Iraq in return for arms shipments. [redacted] Although direct Soviet participation in Iraq's energy sector remains well below levels of a decade ago, the Soviets currently are involved in survey and predevelopment work at the West Qurma oilfield, installation of computer automation at the New Karkh storage depot, provision of telemetry for pipelines, and erection of a new dam and hydroelectric power plant at Al Haditha. [redacted]

Relations with Tehran have deteriorated with the expulsion this year of 18 Soviet diplomats from Iran and Tehran's ban on the Communist Tudeh Party. Despite this, the Soviets are still engaged in oil trade with Iran, buying about 40,000 b/d of Iranian crude [redacted] An Iranian gas export contract with the Soviet Union was abrogated by Tehran in 1980 because of a pricing dispute. Despite the fact that shipments have never resumed, Iranian gas still has considerable appeal to Moscow, as evidenced by the Soviet approach to Tehran to resume exports last year. [redacted]

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Algeria, Nigeria, Venezuela. The USSR also has considerable energy-related ties to Algeria, Nigeria, and Venezuela. In Algeria, for example, the Soviets are extensively involved in oil and gas projects, including the construction of a major gas pipeline. In Nigeria, the Soviets are engaged in constructing a gas pipeline along with other economic projects [redacted]

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Saudi Arabia. The Saudis have worked hardest at keeping the Soviets at a distance—even in oil-related dealings. Some indirect connections, however, are at play. Saudi Arabia, for example, will provide at least $1.2 billion in crude oil to Soviet customers to cover Iraqi financial obligations to the USSR under an agreement reached in May, according to the US Interest Section in Baghdad. The Saudis are making the oil available to financially strapped Iraq as a form of war assistance and have taken no part in the selection of customers. [redacted] The Saudis, in fact, have deliberately avoided direct dealings with Soviets. The US Interest Section reports that a Soviet official in Baghdad applied for a Saudi [redacted]

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visa to assist in the arrangements from Saudi Arabia but was turned away by the Saudi Embassy. [redacted]

Others. The Soviets have little direct oil dealings with other OPEC members. Moscow does conduct some military trade with Kuwait, and Soviet officials have pointed to their relationship with Kuwait as a model for establishing similar ties with Saudi Arabia. [redacted]

Looking Ahead

In the present oil-surplus situation, OPEC members reportedly believe that their pricing structure can only be upheld with the cooperation of the USSR and the other major non-OPEC oil exporters. Thus, we believe OPEC favors further contacts with the USSR and is likely to maintain this policy as long as the risk of a price collapse remains considerable and OPEC members are producing below their preferred level of about 23 million b/d. Nonetheless, most OPEC members prefer to separate cooperation in the oil market from other national policies, as they have demonstrated in the present Iran-Iraq conflict. The more conservative states in particular are trying and will continue to try to limit their contacts with the USSR to the minimum necessary to attain Soviet support in the oil market. [redacted]

The market will to some extent continue to determine the course of OPEC's relations with the USSR. Should the market continue to strengthen, as it has in recent weeks, OPEC as an organization would see less need for formal contacts. Even in this case, however, we believe that some ties would be maintained; the OPEC Oil Ministers are well aware of the volatility of the market and the possibility of a renewed need for Soviet cooperation. If, on the other hand, oil consumption were to decline sharply, requiring further cutbacks by producers, OPEC's need for Soviet support could lead the cartel to seek a more formal arrangement with Moscow. [redacted]

On the Soviet side, we believe that short-term needs to maximize hard currency earnings may prevent Moscow from taking full advantage of opportunities for expanded contact. Although it has long been a goal of the Soviet Union to increase ties with the conservative oil powers of the Middle East, deteriorating market conditions could place Moscow in a position of having to compete rather than cooperate with OPEC. Under these circumstances, the Soviets would be forced to make some hard choices, and we believe the need to maximize hard currency earnings would dictate a sharp divergence from OPEC policies at the expense of political goals. Under present circumstances, however, the Soviets are able to reconcile their political and economic goals by casting their inability to raise exports as a means of cooperation, enabling Moscow to appear as a collaborator in firming the oil market. If the market remains sufficiently stable, the Soviets may be able to continue a policy of apparent cooperation that requires no economic sacrifice of their own. [redacted]

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